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The Framework of Trade in the Council for Mutual Economic Assistance

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This paper establishes an overview of the variables and constraints that affected trade in the Council for Mutual Economic Assistance. It explores the origins of COMECON, the demographic and resource distribution of the member nations, and the role of trade in a centrally planned economy. The paper's primary focus is on the emergence of a bilateral trade structure, the faulty price mechanism, and the nonconvertibility of currencies. The paper documents the origins and relationships between the constraints of trade within COMECON, and argues that ultimately, these constraints prevented COMECON from fully achieving its economic objectives.

Foreword:

In my contemporary American education, the study of Economics was nearly solely made up of the study of market economies. The topic of planned economies had always been a source of personal interest, but I had little exposure to the existing literature. It was not until I encountered some basic facts about the Council for Mutual Economic Assistance (referred to as COMECON, CMEA, or CEMA in academia) in a political science paper that I had a starting point for further research. While the research was often tedious, and it took a great deal of effort to distinguish between reliable and unreliable data sources, the results were fascinating. Understanding the complexity of COMECON and its member nations from an economic, political, and cultural standpoint contributed to a greater understanding of the conflict between the Eastern and Western countries.

The degree of success of COMECON as an organization is debatable. Certainly, the body was not used to its full capabilities as a source of socialist economic integration. However, given certain non-economic influences in the region, perhaps COMECON was somewhat successful as a method of fostering development in the member economies after World War II. If the aim was to support a system of centrally planned economies, and to expand Soviet influence and ideologies, for a time, COMECON performed this function. Nevertheless, a philosophy of autarky, a reliance on bilateral trade, the lack of a reliable price mechanism, and nearly complete currency inconvertibility prevented COMECON from achieving economic optimization among the member nations.

I. The Origins of COMECON

The devastation of World War II created a power vacuum in Central and Eastern Europe that the Soviet Union was only too eager to fill. Prior to the war, a large portion of Central and Eastern European trade had been transacted outside the region, especially with the German Reich.[1] Immediately following the conflict, the USSR made grain loans to help ease the regional food shortage, and accepted whatever countries had to offer in return for raw materials and other essentials. It was not an equitable trade structure—countries were essentially forced to accept the Soviet terms, or make do without basic necessities. Through these trade agreements, reparations claims, and control over key activities, the USSR acquired a dominant economic position in Eastern Europe.[2]

In the aftermath of the war, the Communist party seized control of nations throughout Eastern Europe. In many areas of the continent, the emerging Russians had appeared as liberators, contrasted with the preceding oppressive Nazi regime. However, the USSR had to compete with its Western wartime allies for regional influence. In the immediate postbellum period, it quickly became apparent that these two parties had very different views on the solution of political, social, and economic problems, to the point where two Europes emerged, separated by the so-called Iron Curtain.[3]

Given their extended military presence after the war's conclusion and the restoration of civil order, the Soviets were clearly seeking to use their satellite nations as a buffer zone for national security. In addition, the USSR sought to propagate its ideology throughout the region. The Western powers, led by the United States, introduced a massive aid program through the

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[1] van Brabant, Jozef M. *Socialist Economic Integration: Aspects of Contemporary Economic Problems in Eastern Europe.* New York: Cambridge University Press, 1980.

[2] van Brabant, *Socialist Economic Integration,* pg. 28.

[3] Mellor, R.E.H. *COMECON: Challenge to the West.* New York: Van Nostrand Reinhold Company, 1971.

Marshall Plan, open to any European nation, regardless of affiliation with the Eastern or Western bloc. Seeing the tremendous, widespread appeal of the Plan, and sensing the victory its acceptance would mean for Western influence, the Soviet authorities abstained from cooperation, claiming that the terms of the aid violated national sovereignty.[4]

Nevertheless, Czechoslovakia formally accepted membership to the program, and Poland decided to join as well. However, both nations bent to the Soviet pressure and withdrew. As a result, no Soviet bloc country participated in the Organization for European Economic Cooperation, the program established in 1948 to administer Marshall Plan aid, or realistically cooperated with the United Nations agency encompassing all of Europe, the ECE.[5] Obviously, to exert such vehement refusal of economic aid, the Soviet bloc had to offer its members some alternative. This proposal became the Council for Mutual Economic Assistance.

COMECON was officially founded at a conference in Moscow in January of 1949. The founding nations were Bulgaria, Czechoslovakia, Hungary, Poland, Romania, and the Soviet Union. Within a month, Albania joined, and eastern Germany, the German Democratic Republic (GDR), was added the following year. Over time, Mongolia (1962), Cuba (1972), and Vietnam (1978) would also be awarded membership. On January 22, 1949, COMECON released its first communiqué. This document was the body's only policy statement for eight years, and served as its acting constitution for eleven years. It is reproduced here, as found in Kaser[6]:

> In January of this year an economic conference was held in Moscow attended by delegates from Bulgaria, Hungary, Poland, Rumania, the USSR, and Czechoslovakia. The conference noted considerable successes in the development of the economic relations among the countries concerned and above

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[4] Mellor, "COMECON: Challenge to the West", pg. 3.
[5] Mellor, "COMECON: Challenge to the West", pg. 3.
[6] Kaser, Michael. *COMECON: Integration Problems of the Planned Economies.* London: Oxford University Press, 1967.

> all the great rise in the turnover of trade. As a result of the above-mentioned economic relations and the implementation of economic co-operation between the countries of people's democracy and the USSR, conditions have been created to accelerate the restoration and development of their national economies. The conference further observed that the Governments of the United States of America, of Great Britain, and of certain western European states had boycotted trade relations with the countries of people's democracy and the USSR because these countries did not consider it appropriate that they should submit themselves to the dictatorship of the Marshall Plan, which would have violated their sovereignty and the interests of their national economies. In the light of these circumstances, the meeting studied the question of the possibility of organizing wider economic co-operation between the countries of people's democracy and the USSR. To establish this wider economic co-operation between the countries of people's democracy and the USSR, the conference considered it necessary to create the Council for Mutual Economic Assistance between the countries represented—on the basis of equal representation and with the task of exchanging economic experience, extending technical aid to one another and rendering mutual assistance with respect to raw materials, foodstuffs, machines, equipment, etc. The meeting decided that the Council for Mutual Economic Assistance would be an organization open to other countries of Europe sharing the principles of the Council for Mutual Assistance and desirous of participating in the widening of economic co-operation with the above-mentioned countries. The Council for Mutual Economic Assistance would take a decision only with the agreement of the interested country. The Council shall meet periodically in the capital of each of the signatory countries in turn under the chairmanship of representative of the country in whose capital the session takes place.

This communiqué has several highlights. It espouses the Soviet principle of national sovereignty used as justification for denying Marshall Plan aid. COMECON encouraged national self-sufficiency, not necessarily full economic integration. A common misconception is that COMECON was one supra-national planning body. In fact, as stated by Hewett, "… while it is an association of similar centrally planned economies (CPE's), it is itself a *decentralized, non-centrally planned* economy."[7] As clearly stated in the passage, "The Council… would take a decision only with the agreement of the interested country."[8] Participation in any COMECON

[7] Hewett, Edward A. *Foreign Trade Prices in the Council for Mutual Economic Assistance.* New York: Cambridge University Press, 1974.

[8] Kaser, *COMECON,* pg. 12.

program was voluntary, even to members, severely limiting the Council's effectiveness as a planning body.

The communiqué also refers to the trade embargo placed by the Western countries upon non-participants in the Marshall Plan. At the time of the founding of COMECON, about 50 percent of internationally-traded goods were under embargo to its members and the People's Republic of China.[9] Initially, post-war reconstruction, despite the blockade, was a large motivator for the creation of COMECON. The overarching goal was for member nations to coordinate their efforts and use trade as a tool for the economic development of the individual economies. [10] To achieve this maturation, member nations would follow the model of development espoused by Lenin and Stalin focusing on heavy industry.

COMECON remained largely dormant until Stalin's death in 1953. As an organization, COMECON gradually gained strength, and the members became more intertwined, up until its end with the demise of the Soviet Union. However, along the way, efforts to centralize control were met with vehement opposition from a number of member nations, and as such, full integration was never realized. Khrushchev was instrumental in creating the structure of COMECON, and in June of 1962, the body adopted a more detailed governing document, the "Basic Principles of the International Socialist Division of Labor."

COMECON continued to gain supra-national power with the 1971 adoption of the "Comprehensive Program for the Further Extension and Improvement of Cooperation and the Further Development of Socialist Economic Integration," which helped dictate COMECON operations through 1990. While this plan contained more elements of both the planning and market systems, COMECON could never overcome its primary obstacle, which was, according

[9] Kaser, *COMECON,* pg. 15.
[10] Hewett, *Foreign Trade Prices,* pg. 2.

to Zwass, state ownership of the means of production, which faces many more difficulties than private property in international operations.[11]

II. Demographics and an Economic Profile

While over the course of COMECON's history, demographic and economic statistics have varied, and are unreliable at best in their accuracy, they nevertheless play an important role in understanding the structure of trade within COMECON. First and foremost, the dominance of the Soviet Union cannot be understated. According to van Brabant, the USSR composed "roughly 90% of land and energy resources, 70% of the population, 65% of national income, 60% of industrial and 75% of agricultural output, and 40% of foreign trade."[12] The importance of the Soviet Union as a trade partner is detailed by Table 1. Note the especially high dependence on the USSR as a market for Bulgaria, as well as the relatively low dependency of Romania.

Of the satellite nations, the 1938 per capita national product relative to Romania is shown in Table 2, accompanied by population statistics in Table 3. Note the wide diversion in both economic starting points and population resources. In addition, to garner a basic understanding of the initial industrial capabilities of the COMECON members, refer to Tables 4 and 5. This is important because COMECON placed a priority on industrial development, and certain members, such as the GDR and Czechoslovakia, were much better equipped to meet these demands. These capabilities would be controversial points in later years when trying to formulate cooperative plans of specialization, as is touched upon later in this paper. Finally, an initial framework of intra-COMECON trade is provided in Table 6. Note the tremendous

[11] Zwass, Adam. *The Council for Mutual Economic Assistance: The Thorny Path from Political to Economic Integration.* Armonk, New York: M.E. Sharpe, Inc. , 1989.

[12] Van Brabant, *Socialist Economic Integration,* pg. 3.

importance of the COMECON market for all members, but also the especially high importance for Bulgaria and Romania.

Table 1

Share of Soviet Union and the West in total exports of CMEA countries in 1981 (%)

	Share of the Western countries	Share of the Soviet Union
Bulgaria	11.5	48.3
Czechoslovakia	19.6	37.6
GDR	26.5	36.5
Poland	29.5	34.2
Romania	29.8	20.8
Hungary	30.2	41.8
CMEA (6)	29.5	35.9

Source: *Rat für Gegenseitige Wirtschaftshilfe*, Ostkolleg der Bundeszentrale für politische Bildung, Cologne, 1985, pp. 160, 162.

Source: Zwass, *The Council,* pg. 47.

Table 2

Per capita national product (1938) relative to Romania

	National product per capita in US$	Ratio to Romania in %
Romania	*38*	*100*
Bulgaria	43	113
Poland	63	166
East Germany	189	497
Czechoslovakia	103	271
Hungary	63	166

Source: Zwass, *The Council,* pg. 7

Table 3

Size of Population
(average annual: thousands of persons)

	1950	1960	1970	1972
Bulgaria	7.250	7,867	8.490	8,581
Hungary	9.338	9.984	10.329	10.398
GDR	18,388	17,241	17,058	17.043
Cuba	5,368	6.826	8.553	8.732
Mongolia	780	952	1,248	1,320
Poland	24,824	29.561	32.473	33.027
Romania	16,311	18.407	20,250	20,660
USSR	180,075	214.334	242.757	250.000*
Czechoslovakia	12,389	13,654	14.334	14.478

*1973.

Source: Galetskaia, R. "The Demographic Situation in COMECON Member Nations." *Voprosy ekonomiki*, 1974: 80-101.

Table 4

Per capita industrial output in 1950 compared to the Soviet Union (%)

Soviet Union	*100*
Bulgaria	43
Czechoslovakia	143
GDR	136
Poland	70
Romania	31
Hungary	78

Source: Zwass, *The Council,* pg. 10.

Table 5

Share of industrial employees in total employment (1950)

	%
Bulgaria	13.0
Czechoslovakia	30.0
East Germany	41.2 (1952)
Poland	17.8
Romania	12.1 (1951)
Hungary	19.7
Soviet Union	23.5

Source: Zwass, *The Council,* pg. 10.

Table 6

Share of CMEA in total exports in 1950 (%)

Total	61.4
Bulgaria	91.8
Czechoslovakia	54.1
GDR	68.0
Poland	55.9
Romania	89.2
Hungary	66.4
Soviet Union	58.1

Source: Zwass, *The Council,* pg. 12.

III. The Economic Model of a Centrally Planned Economy (CPE)

As we have established, while COMECON itself was not a complete centrally planned economy, its member nations were all CPE's. Therefore, it is imperative to have a working understanding of the salient features of CPE's, and their underlying models. Van Brabant offers a thorough analysis of the traditional CPE. To begin, he identifies eight basic characteristics of socialist economic policies:[13]

1. To enforce a growth strategy, nearly all economic activities are brought under detailed central planning, and decision-making authority is vested in a complex administrative hierarchy.
2. All important production factors and institutions are nationalized or closely controlled by the state.
3. Collectivization is the dominant pattern of socialist agriculture, with the nominally cooperatively owned farms under close state control.
4. Fiscal, price, and monetary policies are subordinated to the realization of physical growth targets, especially those pertaining to forced industrialization. Prices are administratively set, often below market-clearing levels, and infrequently changed. Money is held passive, especially in the production sphere, with the flow of funds adjusted by taxes, subsidies, and credits according to the allocation of resources previously earmarked in physical terms.
5. The rigid planning and organization of the productive structure is complemented by informal initiative at all levels of production and consumption. *While central planning sets the overall economic profile, it cannot possibly accurately forecast the entire economy; there is an element of uncertainty to the plan. Thus, it is dependent upon individuals at all levels, and especially, the lower levels, of production and consumption to exercise limited initiative to allow the economy to continue to function* (my italics).
6. Bureaucratization of economic activities ensues as production and its disposition are enforced by administrative allocation criteria or, in other words, by rationing of materials and central control over wage disbursements (both the total wage bill and its components). Managerial and worker incentives are tied primarily to the fulfillment and overfulfillment of centrally decreed production targets.
7. The CPE is to a considerable extent politicized as a result of the gradual evolvement of the Communist Party, inter alia, into an instrument of channeling production factors preferably into activities corresponding to the economic and other goals of socialism.

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[13] Van Brabant, *Socialist Economic Integration,* pg. 71-72

8. Internal economic activity is rigidly insulated from external influences and from the foreign economic relations of the CPE, and the actual or potential effects propagated by unavoidable contacts abroad are neutralized by means at the disposal of the planning center. Trade tasks are generally entrusted to special export-import corporations, who see to it that producing enterprises have no direct contact with foreign customers or suppliers, and their interest in the economic effects of foreign trade is deliberately kept weak.

Several of these features are explored in detail below. However, first, we must examine the role of trade in a traditional CPE.

As previously stated, the initial framework of COMECON placed a high level of value on national sovereignty. Autarky was a stated goal, and it was the objective of all member nations to be largely self-sufficient. Trade was not viewed as an efficiency mechanism; rather, trade was only used to cover essential purchases of goods that the domestic economy was unable to supply to subsistence levels. This was accomplished through the maintenance of materials balances, a sample of which is shown in Table 7. Briefly, a material balance is the record of inflows and outflows of a given product, in coordination with the production plan in a CPE. Intra-COMECON trade was transacted largely bilaterally, based on physical units rather than on the

Table 7

A simplified material balance: product x *in plan year* t
(physical units)

Origin	Destination
Free and fixed[a] reserves (beginning of *t*)	Domestic consumption in *t*
	Final private consumption
	Interindustrial use
Commodity production in *t*	Social consumption
Contracted imports[b]	Contracted exports[b]
From socialist countries	To socialist countries
From nonsocialist countries[c]	To nonsocialist countries[c]
Other sources of supply	Free and fixed reserves (end of *t*)
Other imports	Other exports
From socialist countries	To socialist countries
From nonsocialist countries[c]	To nonsocialist countries[c]

[a]For example, strategic reserves of grain.
[b]Resulting from previous trade and payments agreements, including obligations stemming from specialization and cooperation protocols.
[c]This is usually further disaggregated into trade with convertible currency countries and other countries, sometimes according to whether the partners belong to the developing countries group or to developed market economies.
Source: Adapted from Grote 1973, p. 101.

Source: van Brabant, *Socialist Economic Integration,* pg. 102.

price mechanism. The nature of this bilateralism, the lack of effective pricing, and the non-convertibility of currency are explored in greater detail below.

To illustrate the role of trade in a traditional CPE, van Brabant proposes a general-equilibrium model with two countries, two production factors, and two commodities. We show the model graphically in Figure 1, and offer an explanation below.

1. The role of trade in a traditional CPE

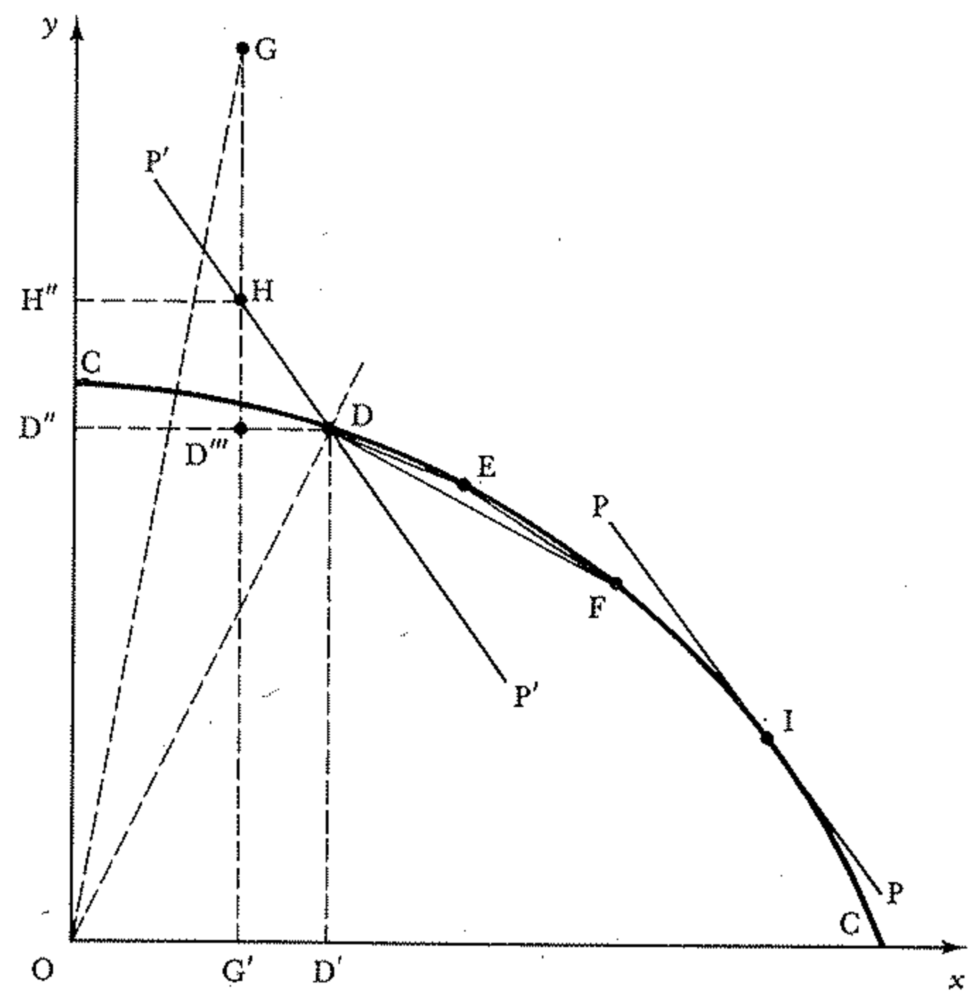

Figure 1. Production and trade choices in a traditional CPE.

Source: van Brabant, *Socialist Economic Integration,* pg. 105.

In this diagram, the curve *CC* represents a production possibilities frontier for the representative economy. Any point on the curve, such as sample points *D, E*, or *F,* as well as any point within the curve, represents a feasible production combination of two goods, in this case *x* (foodstuffs), and *y* (investment goods). In a market economy, the optimum production point would be at the point where the international price ratio line, defined here by *PP*, is tangent to *CC,* here point *I*.

However, many centrally planned economies, and especially, the COMECON member nations, have a tendency to emphasize industrial development. Therefore, it is likely that a central planner would pursue a more industry intensive production combination, such as point *D*. In this case, assuming the international price ratio still holds (a momentous assumption, as will be discussed), production occurs at a marginal rate of transformation according to the shifted price ratio line, *P'P'*.

Now, to incorporate trade. Perhaps the central planner sets a production target of point G, a highly industry intensive objective located at the subsistence level of foodstuffs, represented here by the distance *OG'*, and extended through the vertical line *G'G.* Assume the country still produces internally at point *D,* creating a surplus of foodstuffs compared to the central plan. That surplus foodstuffs can be transformed through trade into investment goods along *P'P'* to obtain investment goods of amount *D"H"*, achieving product mix H. While still short of *G*, point *H* could be preferable to any point along the production possibilities frontier in the absence of trade.

IV. Bilateralism

It can be readily understood based on the prior discussion how a bilateral trade structure emerged in COMECON—a collection of independently functioning CPE's. As both parties to an intra-COMECON bilateral trade are central planners, purely quota-based resource exchange allows for a high degree of control in international capital and goods movements. The model helps insulate the CPE's from external market influences and variances, helping to ease the immense task of the national economic planner. From a slightly more cynical perspective, bilateral trade was favored by the USSR as a mechanism to expand their political supremacy and hegemony over Eastern Europe.[14] In addition, by transacting trade bilaterally, the USSR acquired suppliers who were both 1) dependent on the Soviet market and 2) willing to design their outputs to Soviet specifications and standards, perpetuating Soviet economic dominance of the region.

Furthermore, initially, keeping the foreign trade account balanced was only an aim of the COMECON nations. However, with the creation of the International Bank for Economic Cooperation (IBEC) in 1964, it became a requirement for members to have a zero balance with all COMECON countries. There was no stipulation on balances with individual countries, only that the balance with the entire bloc should be balanced. Nevertheless, the new system did not eliminate the continuation of prior practice; one certain way for a member to achieve overall balance in foreign trade was to maintain bilaterally balanced accounts with each member nation.[15]

A bilateral structure also emerged immediately after World War II because at the time, it was difficult to acquire sufficient hard currency reserves given the general economic uncertainty. In addition, bilateral agreements provided for trade financing with short-term credits, an option that would not have been as available with convertible currency.[16] Furthermore, in the initial post-war period, Western markets were unable to fully commit themselves to the COMECON

[14] van Brabant, *Socialist Economic Integration,* pg. 124.
[15] Hewett, *Foreign Trade,* pg. 15.
[16] van Brabant, *Socialist Economic Integration,* pg. 131.

countries, and the USSR entered as the dominant trade partner, all too willing to fill the trade vacuum. Gradually, member nations specialized their processes according to primarily Soviet standards, making trade with other parties and regions all the more difficult.

Another important facet of the bilateral system of COMECON was the distinction between "hard goods" and "soft goods". To summarize, goods that could be sold without restriction on the Western markets and goods in which demand exceeded supply within COMECON were considered hard goods.[17] Two examples of hard goods were crude oil and meat. In contrast, soft goods had no ready alternative market, yet still had a market within COMECON. These goods would only be transacted in bilateral trade to settle balances or to free capacity for other production. The key element is that countries would only transact hard goods for hard goods, and soft for soft. Fink refers to this problem as a lack of "product convertibility."[18]

To continue the explanation, Fink proposes an analogy. Suppose two young cats are traded against one young dog. Note that it is irrelevant whether each cat is priced at 2 marks and the dog at 4 marks, or whether each cat cost 1 million marks and the dog 2 million. In either case, the soft goods, cat-dog account balances and clears. Now, suppose one cat is not delivered. The dog exporter has a problem in the form of a million mark surplus. The cat exporter would be entirely unwilling to settle the soft goods account by, say, delivering crude oil at a price of 260 DM per ton (hard goods). The party would refuse to export crude oil in return for soft goods, and so perhaps, as an alternative, will propose two canaries at 500,000 marks each to

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[17] Fink, Gerhard. "Settlement System and Hard Currency Trade in the CMEA." *Soviet and Eastern European Foreign Trade, vol. 22, no.1*, Spring 1986: 68-82.

[18] Fink, "Settlement System…", pg. 70.

clear the cat-dog account.[19] It is readily apparent that under this system, unplanned balances could not be cleared multilaterally without incredible difficulty, leaving bilateral trade as the only workable alternative.

While it is true that prices were determined by the parties of a bilateral agreement, and are largely only relevant for accounting purposes in a CPE, simply the lack of an effective pricing mechanism is not sufficient justification for the existence of bilateral trade. Likewise, the stated exchange rates are largely redundant, as the lack of corresponding purchasing power renders COMECON currencies inconvertible. Certainly, these factors are worth exploring, and will be detailed below, but they fall short as fully explanatory variables for bilateral trade.

Over the course of COMECON's history, the bilateral trade structure has been maintained despite pressure to become more market oriented, or at least, more integrated. While there were apparent advantages to specialization, member nations resisted deviation from the heavy industry-based model of development set forth at the Council's creation. No nation wanted to undergo the painful process of reequipping their economy according to new specialization criteria.[20] Moreover, in a region with such a heavy ideological influence, no nation wanted to suffer the indignity of being relegated to the support structure of the bloc, such as agriculture. Finally, the focus on national self-sufficiency and autarky maintained its prevalence, and there was a strong resistance to any all-powerful supra-national body.

F.D. Holzman introduces five reasons for why bilateralism not only exists in CPE's, but was largely maintained through the demise of COMECON: [21]

(1) Trade partners are unwilling to hold balances of CPE currency
(2) The CPE strives for overall trade balance

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[19] Fink, "Settlement System…", pg. 72.
[20] van Brabant, *Socialist Economic Integration,* pg. 155.
[21] Holzman, F.D. "Foreign Trade Behavior of Centrally Planned Economies." *In Rosovsky 1966*, 1966: 237-265.

(3) The economically stronger nations obtain opportunities to improve their terms of trade
(4) Bilateral balancing is a carryover from the general use of analogous techniques in domestic planning, and
(5) Non-bloc countries prefer bilateral arrangements because of balance of payments problems

Van Brabant expands that bilateralism has been maintained based on the economic trauma induced by the two wars, the extension of trade controls under central planning, the preference of a bilateral approach by the USSR, and the difficulties of multilateral trade negotiations for countries lacking convertible currencies, an issue detailed below.[22] In summary, while economic motives might suggest that the bilateral structure of trade had passed its time, many non-economic motives prevented COMECON from seeking and supporting viable alternatives.

V. Pricing

The early COMECON nations adhered to the Stalinist philosophy that fixed prices were the best alternative. Initially, the parties in a bilateral agreement were given the power to set prices, and typically, the equivalent world market prices were used. However, various agreements valued the prices at different times during the process of trade, and as such, hindered price universality. Planning is obviously facilitated if either prices or quantities are fixed; and between the two, the former are the obvious choice.[23] From 1945-1950, the challenge of maintaining planning targets in the face of fluctuating world market prices prompted the search for an alternative.

Beginning in 1950, rubles were introduced as the unit of account for bilateral balances within COMECON. Also in 1950, world prices saw a sharp increase as a result of the conflict

[22] van Brabant, *Socialist Economic Integration*, pg. 132.
[23] Hewett, *Foreign Trade Prices,* pg. 27.

in Korea. Again, one of the goals of COMECON was to isolate intra-group trade flows from world market disruptions, so the members moved to freeze contractual prices at an average of their 1949-1950 (first half of 1950 only) levels.[24] Officially, the static prices were in effect from 1951-1956, a period frequently referred to as the "stop price" period.[25] However, by the second half of that period, international markets had normalized. The COMECON nations began to renegotiate prices if the five or ten most important commodities in each bilateral trade flow no longer approximated their respective world market prices.

The 1954-1956 period was an inflection point. As previously stated, different bilateral agreements used different methods of price calculation. In addition, none of the commodity costs reflected existing cost parameters, and most prices reflected world market prices that were several years old. Furthermore, the prices for identical goods differed significantly in various bilateral agreements.[26] As a result, for the trading year 1957, the member nations attempted to establish a universal price level for various commodities among all socialist countries. However, recall that participation in directives of COMECON was voluntary. Several member nations, notably, Bulgaria and Poland, failed to adopt the full program when it was not to their advantage.

This systemic problem was also reflected after the adoption of the COMECON Price Clause at the IX Session of COMECON in 1958. The Price Clause was meant as a set of guidelines of the accepted bargaining practices in intra-COMECON trade. Hewett summarizes the proposal:[27]

> The procedures outlined below are designed to guide negotiators in the location of a world market price existing in a generally agreed upon period of time, and in its subsequent adjustment to obtain an estimate of the true value of the CMEA commodity according to international cost standards.

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[24] Hewett, *Foreign Trade Prices, pg*. 27.
[25] Hewett, *Foreign Trade Prices,* pg. 28.
[26] Hewett, *Foreign Trade Prices,* pg. 30.
[27] Hewett, *Foreign Trade Prices,* pg. 31-32.

> The final contractual price is the result of a three-stage procedure:
> 1) The selection of a basic world market and thus a world price
> 2) The adjustment of this price to compensate for value-distorting influences and for CMEA's geographic location relative to the world markets used.
> 3) The decision that in some cases, there will be a deviation from the value estimated in the first two stages, in order to stimulate the production of certain commodities.

Even these guidelines leave much room for variation. Which market should be chosen? How should the world market price be measured?[28] Because trade was still transacted bilaterally, the two parties could proceed according to their wishes anyway. It is readily apparent that the Price Clause still was not an effective mechanism for price coordination.

By the mid 1970s, more adjustments were made. Rather than calculating the price basis at a single point in time, historical world market prices of the principal world markets were averaged, typically for a five-year period, to eliminate one-time fluctuations.[29] This alteration was known as the Bucharest formula. However, the same problems of participation still existed. Even by the mid 1980s, towards the end of COMECON's existence, the price system was still a burden. As noted by Jackson, the majority of members wanted it changed to better reflect world market values. Yet, the problem was that each member only wanted changes that would improve their terms of trade within the bloc. Under any change, there would be winners and losers. The projected losers attempted to veto any changes, and so "the system limp[ed] along."[30]

It is worth noting that the lack of efficient pricing within COMECON and the bilateral structure of trade created a circular situation. As stated by Kaser, "With neither centralized negotiations nor a free market to bring these prices into equilibrium, each partner could be

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[28] For a further discussion of the problems faced by the COMECON Price Clause, see Hewett, pg. 32.
[29] van Brabant, *Socialist Economic Integration,* pg. 136.
[30] Jackson, Marvin. "When Is a Price a Price? The Level and Patterns of Prices in the CMEA." *Soviet and Eastern European Foreign Trade, vol. 22, no.1*, Spring 1986: 100-112.

assured of an equitable balance of advantage only if both trade and payments were strictly bilateral."[31] And, under bilateralism, price levels are not important, only the ratio between them. As will be explored below, COMECON eventually instituted many reforms to promote multilateralism, notably the introduction of the transferable ruble in 1964. However, this situation of autonomous pricing and mandatory balancing of accounts rendered them mute, perpetuating the bilateral system.

Another point that requires mention is that, if the commodities sold in intra-COMECON trade actually appeared on world markets, the stated "world market price" might change significantly.[32] For example, by the early 1980s, the USSR was exporting approximately 80 million tons of oil annually to the core COMECON countries, worth approximately $18 billion at prevailing market prices.[33] If that massive supply was added to the market equation, as well as 80 million tons of demand, it would surely alter the market price.

Beyond Nominal Prices

However, to solely consider the accounting prices as the full cost of intra-COMECON trade would be to shortchange reality. As an example, Merkin explored the true cost of energy supplied to COMECON by the Soviet Union, once so-called "compensation projects" were taken into account.[34] He cites a Polish paper published in 1984 by Hylewski, which details the framework of Polish participation in the Orenburg gas pipeline and Polotsk oil pipeline projects,

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[31] Kaser, *COMECON,* pg. 178.
[32] *Deficits and Détente,* pg. 22.
[33] *Deficits and Détente,* pg. 22, 25.
[34] Merkin, Victor. "Intra-COMECON Bargaining and World Energy Prices: A Backdoor Connection?" *Comparitive Economic Studies, vol. 30, no.4*, Winter 1988: 24-51.

two energy transport projects geographically located in the USSR. To summarize the key points of the agreement:[35]

- Poland agreed to supply a set amount of construction work for the USSR in return for the option to buy an agreed-upon amount of fuel over a set period of time; *Poland received no other benefit for their investment* (my italics)
- No connection was made between the amount or cost of the supplied construction work and the amount of fuel made available through the agreement
- Deliveries of fuels at execution of the Polish option to buy were made at prevailing COMECON foreign trade prices
- The scope of construction work to be performed was negotiated, with labor inputs estimated at rates below both actual cost and levels established in COMECON for similar projects
- The included conditions resulted in Soviet payments for the export of construction falling far short of the outlays of funds actually made by Poland

In effect, Poland purchased a call option on Soviet energy in return for discounted construction exports, raising the price on energy that nominally was undervalued compared to world market prices.

Polish analysts conducted studies to estimate the effectiveness of entering into such agreements, versus the alternative of purchasing a similar amount of fuel on the open market. Tables 8 and 9 illustrate their results. Table 8 provides the “magnitude of the surcharge” to the COMECON energy price in a given year, with the cost of the option equated to exports of construction work at a loss.[36] Taking oil in 1982 as a representative entry, from Table 9, section D, we see that the “full” price of oil (100 percent) was composed of a 62.9% nominal component, and a 37.1 percent option premium. From Table 8, under 1982 and assuming 10% interest on the cost of the option, it is suggested that oil was 59% more expensive than the nominal COMECON price. Under the Bucharest formula (5-year moving average), in a period

[35] Merkin, “Intra-COMECON Bargaining…”, pg. 25.
[36] Merkin, “Intra-COMECON Bargaining…”, pg. 26.

of rising prices, the nominal price of Soviet energy would be below prevailing market rates. However, these compensation agreements allowed the USSR to increase the value received.

Table 8

Ratio of the Cost of the Polish Option to Buy Fuels in the USSR and Nominal COMECON Prices of Fuels*
(Percent; COMECON fuel price = 100 percent)

Ratio as of	Natural gas		Oil	
	Cost at zero interest	Cost at 10% interest	Cost at zero interest	Cost at 10% interest**
1974	44.0	111.9	147.4	229.0
1980	16.6	43.8	50.9	79.0
1982	12.5	33.0	38.0	59.0

*Price comparability assured at the level of 1980 by using the indices of price movement in Polish trade with the first payments zone [planned economies] and exchange rates and coefficients in effect in 1980.

**Average cost.

Source: *Studia ekonomiczne Instytutu Nauk Ekonomicznych PAN*, 1984, vol. 5, p. 293.

Note: Cost of the option to buy is defined as the difference between the actual cost of the project to Poland and the payments received from the USSR, divided by the amount of fuel generated by the agreement. All costs and interest are taken into account, whether borne by Polish construction enterprises or directly by the state budget. For outlays in transferable rubles and hard currency, the indices of price movement in Polish ruble and hard currency-denominated imports, respectively, were applied to convert all data to the 1980 level. Outlays in the national currency (zloty) were included at nominal value, since a commonly accepted inflation index for the years in question is not available. Also, the Polish analysts compiling the table believed that the growth of wholesale prices in Poland during the Orenburg project was modest. Outlays on the Polotsk oil pipeline in 1982 and 1983 are estimated in 1980 prices. A 10 percent interest rate was considered appropriate by the Polish experts in their capital-short economy.

Source: Merkin, "Intra-COMECON Bargaining…", pg. 27.

Table 9

Structure of the Full Price*
of Soviet Hydrocarbons Delivered to Poland
Under "Compensation" Agreements
(1974-1982)

Year	Nominal COMECON price (percent)	Cost of the option to buy (percent)	Full price (percent)
A. NATURAL GAS, ZERO INTEREST ON THE COST OF THE OPTION			
1974	69.3	30.7	100.0
1980	85.8	14.2	100.0
1982	88.9	11.1	100.0
B. NATURAL GAS, 10 PERCENT INTEREST ON THE COST OF THE OPTION			
1974	47.2	52.8	100.0
1980	69.5	30.5	100.0
1982	75.2	24.8	100.0
C. OIL, ZERO INTEREST ON THE COST OF THE OPTION			
1974	40.4	59.6	100.0
1980	66.3	33.7	100.0
1982	72.5	27.5	100.0
D. OIL, 10 PERCENT INTEREST ON THE COST OF THE OPTION			
	Regular COMECON Price		
1974	30.4	69.6	100.0
1980	55.9	44.1	100.0
1982	62.9	37.1	100.0

*Full price equals the sum of the nominal COMECON price (for 1980 and 1982, the moving-average price) and the cost of the option to buy fuel in a given year.

Source: Merkin, "Intra-COMECON Bargaining…", pg. 28.

An alternative, somewhat more controversial view espoused by American researchers Marrese and Vaňous, posits that the implicit subsidies from low Soviet commodity prices amounted to payments for "unconventional gains from trade."[37] They suggest that the USSR used economic incentives in place of direct coercion to both solidify the support of their closest satellites and reel in the reluctant ones toward Soviet positions on military and political issues. In addition, they quantify the value the USSR placed on the noneconomic favors it received from each country by summing the estimated subsidies to each nation. Space does not allow a full critique of this argument; however, it is worth noting for the many noneconomic factors at play in COMECON pricing and operations.

Table 10, included below, shows the account balances of the USSR with the so-called CMEA Six (the other six original members of COMECON). Note the rapidly increasing relative values of the implicit subsidies, as well as the increasing balance of trade. This table will be referenced again in the next section of the discussion.

[37] Marrese, Michael and Jan Vaňous. *Implicit Subsidies and Non-Market Benefits in Soviet Trade with Eastern Europe.* Berkeley, CA: University of California Press, 1982.

Table 10

USSR: TRADE WITH CMEA SIX

	Exports	Imports	Balance	Balance officially reported	Balance estimated at world market prices	Implicit subsidy	% on primary products	% on manufactures
	(million current transferable rubles)			(million US dollars)				
1971	6517	6533	−16	−29	883	912	−42	142
1972	6727	7687	−900	−685	−23	662	−44	44
1973	7381	8093	−712	−594	1034	1628	8	92
1974	8705	8600	105	101	6366	6265	83	17
1975	11866	11312	554	472	5797	5325	51	49
1976	13107	12226	881	714	6311	5596	56	44
1977	15266	13852	1414	1190	7128	5938	52	48
1978	16946	16776	170	146	5900	5754	21	79
1979	18549	17491	1058	889	11282	10393	43	47
1980	20919	19095	1824	1680	19170	17490	70	30
1981	24298	21151	3147	2520	21110	18590	n.a.	n.a.

Note: The calculations of percentage shares are done on a slightly different basis for the later years than the aggregate implicit subsidies but should still be close approximations.

Sources: P. Marer, "The Council for Mutual Economic Assistance: Integration or Domination?" (unpublished manuscript); M. Marrese and J. Vanous, "Soviet Options in Trade Relations with Eastern Europe," in *The Soviet Economy in the 1980s*, U.S., Congress, Joint Economic Committee (Washington, D.C., forthcoming); M. Marrese and J. Vanous, *Soviet Subsidization of Trade with Eastern Europe: A Soviet Perspective* (Berkeley: Institute for International Studies, University of California, 1983).

Source: *Deficits and Détente*, pg. 76.

VI. Exchange Rates and Currencies

At this point in the discussion, it should be readily apparent why the currencies of COMECON member nations faced problems of convertibility. No single currency reflected true value because prices were autonomously determined by central planning authorities to settle primarily bilateral transactions. The very concept of money in a centrally planned economy is very different from that in a market environment. As IMF expert Mark Allen describes, "If an enterprise obtains a good this is not because it has spent money from its bank account, but because it has been allocated that good by the plan. The plan is the motive force, and the money flows are merely a response to what has already been decided."[38]

[38] Zwass, *The Council,* pg. 58.

After 1964, the non-convertible transferable ruble served as the settlement unit for intra-COMECON trade. However, as previously noted, the pricing mechanism within COMECON limited its effectiveness. It provided some level of purchasing power within the bloc; yet, purchasers were still limited by the quotas established through central planning. Furthermore, while a unit of account, the transferable ruble still did not reflect cost and price ratios of the member countries, or even COMECON as a whole. Rather, its content was solely based on adjusted prices from the world market.[39]

The reasons for currency inconvertibility are very closely related to the irrelevancy of exchange rates. The price mechanism would have had to have been successfully integrated into the international system to reflect cost and price relations for the exchange rates to have any accuracy. Even if this could have been achieved, the currency and exchange rate would still have no meaning under the Socialist system because importing and exporting enterprises are subject to the will of centrally planned foreign trade associations, eliminating free market tendencies.

The official exchange rates for the member countries were based on an antiquated gold standard established soon after World War II. The refined gold content of the Soviet ruble was set at .987412 grams from 1961 on. Using gold parity with the U.S. dollar (.73662 grams in 1971) , one ruble was set equal to 1.11 dollars until the first dollar devaluation in 1971, then 1.21 dollars until the second devaluation in 1973, and ultimately, to 1.39 dollars, which remained in use even through the late 1980s.[40] These rates became useless as a method of exchange when the dollar was taken off the gold standard in the early 1970s.

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[39] Zwass, *The Council,* pg. 59.
[40] Zwass, *The Council,* pg. 72.

Table 11 shows the ratio of the U.S. dollar to the Polish zloty in various economic sectors as of 1968. Note the variety in purchasing power parity. Also, compare the various ratios to the official exchange rate of between 3 and 4 zlotys per U.S. dollar, as well as the dollar-zloty ratio of 1:24 used by foreign trade enterprises, the State Bank, and the state budget. Furthermore, purchasing power varied according to economic region: in intra-COMECON exports the ratio was 1 dollar to 40 zlotys; in exports to the developing countries the ratio was 1 dollar to 52 zlotys, and in exports to the industrialized West, 1 dollar equaled 60 zlotys.[41]

Table 11

Ratio of US dollar to zloty according to economic sector (in 1968 exports)

	US$ = Zlotys
Average	*48.0*
Machinery and equipment	36.0
Raw materials and fuels	44.8
Agrarian products and foods	83.2
Industrial consumer goods	51.2

Source: Zwass, *The Council,* pg. 73.

Over time, the official exchanged rates slowly became more realistic, as illustrated in Table 12. Notable adjustments occurred in Poland and Hungary, as well as Bulgaria and Romania during the included time period.

[41] Zwass, *The Council,* pg. 73.

Table 12

Exchange rates of Eastern European currencies in the years 1970 and 1983 (in West German marks)

	1970	1983
Bulgaria (1 leva =)	0.90	0.60
GDR (100 marks =)	22.50	18.50
Poland (100 zloty =)	2.00	0.15
Romania (100 lei =)	7.75	3.75
Czechoslovakia (100 kr. =)	8.50	7.00
USSR (1 ruble =)	0.48	0.54
Hungary (100 forints =)	7.00	4.25

Source: Zwass, *The Council,* pg. 75.

However, most countries had not only the official rate, but separate, special exchange rates for non-commercial payments within COMECON, as well as in limited amounts for Western tourism. The presence of several conversion factors rendered the hope of a single, accurate, unified rate of exchange essentially impossible.

By examining the cumulative result of the price and currency conditions from an accounting perspective, the systemic problems of the economic structure of COMECON become clear. As detailed by Portes, foreign trade enterprises transact imports and exports at foreign currency prices, which, for their internal accounts, are converted to units of domestic currency at an accounting exchange rate that fails to reflect the domestic price level. Yet, the central planning body sells imports to domestic users and purchases exports from domestic producers, both at domestic prices. Any accounting surplus or deficit is absorbed by the state budget, rendering any exchange rate useless. Under this system, a trade surplus in either convertible currency (from the foreign market) or transferable rubles (the unit of domestic accounting) or both, could correspond to a deficit in domestic prices. Currency convertibility is not possible under this system.[42]

In light of the preceding discussion, we must reevaluate the accuracy of Table 10. It is readily apparent that the figures presented in the table have undergone several conversions at meaningless rates of exchange. So, while it allows for a brief and general analysis of the data, Table 10 is likely not representative of the true values.

Later in its history, as COMECON sought to increase coordination, currency inconvertibility and the lack of viable exchange rates posed an imposing obstacle. Furthermore, these variables promoted other factors contributing to structural stagnation; specifically, with no universal currency or purchasing power, nations continued to resort to the bilateral trade approach. Eventually, the cumulative effect of these constraints prevented the group from fully achieving its goals.

VII. Conclusion

In summary, several interrelated variables contributed to the inability of COMECON to fully achieve its objectives. These included: elements built into the structure of the group (i.e. the voluntary participation of members COMECON policies), the adherence to a bilateral trade structure, and the inconvertibility of currencies. The driving factor behind all of these was the structure of the centrally planned Socialist economic model and the resulting price system that failed to reflect costs and scarcity values. Even in later years, as COMECON began to move towards more multilateral and market-based objectives, prevailing practices were so entrenched that the potential success of such initiatives was limited at best. Ultimately, the will of the member nations to act in their own self interest above the best interest of COMECON as a whole brought about the downfall of the organization.

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[42] *Deficits and Détente*, pg. 27-28.

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